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## STATE REGULATION OF INSURANCE

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By L. G. FOUSE

President of the Fidelity Mutual Life Insurance Company of Philadelphia

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*Origin.*—The right of the State to regulate corporations created by it is concededly an attribute of State sovereignty. Corporations to whom sacred and important trusts are committed may be properly required, therefore, to make a full exhibit of their condition to a duly constituted authority of the State which is responsible for their existence.

Experience has shown that in the absence of any State regulation, franchises granted by the State have been shamefully abused, and that because of the lack of authentic information it is practically impossible for private judgment, even the best, to be exercised intelligently. "Get rich quick" concerns have been incorporated and men of prominence have appeared as officials, thus combining the legal sanction of the State with the reputations of individuals, which have had the effect of inspiring in some degree public confidence in alluring, but impossible, schemes.

It was because of this condition affecting moneyed corporations, that steps were taken by some of the States as far back as the year 1828, to require them to make report to State officials. While State regulation of banks has been found necessary, and has placed the banking business on comparatively safe grounds, it is even more necessary in the matter of insurance, because an insurance contract—and this is especially true of life insurance—may run for a long time, and generally does not mature until the death of the party who made it. It is right, therefore, that the State by its laws and their enforcement should protect both the maker and the beneficiaries under contracts of insurance. And it is just as important to protect the insurer by law against imposition, collusion and fraud, as it is to protect the insured or assured.

Aside from the fact that under an insurance contract the happening of the contingency insured against may occur far in the future, is the possibility of an insurance company's continuing to pay

its current claims with remarkable promptness, although it may be hopelessly insolvent. The solvency of an insurance company can only be determined by comparing available assets with the present worth of its future obligations, together with the accrued liabilities. The determination of the present worth of its obligations is a technical matter which few individuals can accomplish for themselves. It requires skill and expert knowledge, which under State regulation are provided by the State.

The abuse of the franchise privilege before State regulation of insurance existed was so marked that a special commission in New York State, on application of the companies themselves, was appointed, and in December, 1856, reported its conclusion as follows:

“The only sure method, without serious embarrassment to the companies, we can discover to prevent the organization of fraudulent institutions, and at the same time give the public an opportunity to know at all times the condition of the companies, is to have a system, sanctioned by law, requiring a rigid supervision on the part of the State, which can be accomplished by annual investigation and public registry of their securities,” and, “they should be properly guarded and protected in their legitimate business.”

The origin of State supervision may, therefore, be attributed to franchise abuse and the ruinous practices which obtained theretofore, Massachusetts being the first to establish an Insurance Department in 1855, New York following in 1859.

*History.*—Regulation of insurance by the State as it now exists is of comparatively recent origin. The most rigid regulation recorded in history is that by the German Empire. There is practically no freedom of action on the part of the company management, and little or no provision is made for changed conditions. That which properly belongs to by-laws for the government of the company has been incorporated into the statute.

The other extreme, of liberality, will be found in Great Britain, which country may be said to be the mother of insurance. The keynote of regulation in Great Britain is publicity. Companies are required to file regular, carefully prepared schedules, by which any person of ordinary knowledge may arrive at an intelligent conclusion as to the financial standing of the companies. Great

Britain, however, has always exercised a paternal interest in insurance.

By reason of complaints which had been made to the Government, a Parliamentary Committee was appointed as early as 1720, which was the first Parliamentary Committee on Insurance, but many such committees were subsequently appointed. A report of the Parliamentary Committee which sat in 1844 seems to have been the basis of the weeding-out process which followed. They classified the so-called "bubble companies" under three heads:—

*First.* Those which, being faulty in their nature, inasmuch as they are founded on unsound calculations, *cannot succeed by any possibility*.

*Second.* Those which, let their objects be good or bad, are so ill-constituted as to render it *probable* that the miscarriages or failures incident to mismanagement will attend them; and

*Third.* Those which are faulty, or fraudulent in their object, being started for no other purpose than to create shares for the purpose of jobbing in them, or to create, under pretense of carrying on a legitimate business, the opportunity and means of raising funds, to be shared by the adventurers who start the company.

A registry law was passed, to become operative September, 1844, which was the substantial beginning of insurance legislation, and which in Britain seems to have attained its perfection by the Act of 1870, and amendments thereto.

Britain has upwards of twenty insurance institutes, and several actuarial societies, the oldest of which, the British Institute, was founded in the year 1848. Since the weeding out of unreliable companies between the years 1844 and 1850, the method of regulation in Britain, which is, as already stated, mainly by publicity, has produced very satisfactory results. This is in a great measure due to the development of the scientific aspect of the business. All the world is in a great degree dependent on Britain for scientific treatises on the subject of insurance.

It is only in recent years that organized attention has been given in America to the scientific aspect of the insurance business. The Actuarial Society of America was founded in 1889.

State regulation in the United States occupies a mean between

the hard and fast lines of the German Empire and the liberality and latitude vouchesafe by Great Britain.

As already stated, Massachusetts created an Insurance Department in 1855, and New York in 1859, but Massachusetts did not value policy liabilities by any standard until 1861, and New York did not until 1868. Other States followed, Pennsylvania in 1873, until now all the principal States have not only undertaken to regulate the business by legislation, but have created Departments charged with the execution of the laws in relation to insurance. Every State has enacted laws to regulate the business.

Such laws specify what is necessary to secure a charter in the home State, or a license from another State by way of payment of fees, deposit, execution and filing of papers, and what must be done periodically in order to continue business. The requirements of one State frequently conflict with the requirements of another State. With the view of endeavoring to reconcile such conflicts, and to secure a greater degree of uniformity and harmony in State regulation of insurance, the Insurance Commissioners have assembled in annual convention since 1871 for the interchange of views and opinions.

*Abuse of Power of Regulation.*—Aside from the taxation abuse to which State regulation has given rise, and which will be discussed separately, there are, notwithstanding the many good points, abuses and objections in evidence.

Insurance, in order to get the benefit of the law of average, must of necessity be extended over a wide field. Practice, as well as the natural conditions, has made it an interstate business.

The Legislatures of the several States meet either annually or biennially, and at every session bills are introduced, either willfully or ignorantly, which, if enacted into a law, would seriously embarrass if not entirely destroy the business which has become an essential part of our progress and civilization. This necessitates vigilance, not only on the part of the State officials to whom the supervision has been entrusted, but on the part of the companies, and involves them in no inconsiderable expense.

Notwithstanding such vigilance, laws are frequently enacted in one State which are directly opposed to the laws of another State, and yet the companies already licensed and with business established

in the several States are expected to comply with the conflicting laws, and penalties are imposed if they do not comply. While there has been a marked improvement in this respect through the operation and work of the National Convention of Insurance Commissioners, under the theory and practice of exclusive State supervision it never can be as it should be for the best interests of the people.

The State office of Supervisor of Insurance, whether elective or appointive, is not always filled by one whose experience, training and knowledge fit him for the position, but is liable to be filled by one as a reward for political service, without reference to any special fitness for the discharge of the duties required of him. It is true that the office in the principal States, as a rule, has been filled by men of eminent fitness. Nevertheless, there are many instances, if the facts were generally and publicly known, that would seriously reflect upon the entire system of State supervision.

A little knowledge is admittedly dangerous. A number of the supervisors, by not restraining themselves in office until they have mastered the intricacies of the business, have taken positions which they could not maintain, and which were exceedingly annoying as well as expensive to the companies. There have been supervisors who constituted themselves judges of the law and the facts, and undertook to rule arbitrarily without taking into account equities and results.

As a rule, the officers of States to whom supervision is entrusted are amenable to the courts, and, therefore, any radical departure from sound doctrine and good practice may be checked or corrected by appeal to the courts. A few States, however, notably Massachusetts, leave everything relating to insurance to the opinion and discretion of the Commissioner. Fortunately, the office has been filled by men who have, with a few exceptions, taken no undue advantage of the power conferred on them by law. In view of the magnitude of the interests involved and the uncertainty as to the capability and fitness of the supervisor, no State should enact laws making the opinion and discretion of the supervisor or commissioner final and conclusive. Just as the individual under civic liberty has the right to be adjudged innocent or guilty by a judicial tribunal

so an insurance company should not be deprived of an appeal to such a tribunal in the case of a controversy with a State supervisor.

The law of comity obtains between most of the States, so that the certificate of the supervisor of the home State is accepted, under the provisions of the laws of reciprocity usually incorporated in the statutes of the different States, by the Supervisors in other States. There are, however, a number of States that have no local companies, and reciprocity means little or nothing to the supervisors of such States. Hence, it is not unusual for them to attempt to make independent investigations and valuations at the expense of companies.

Some years ago, junketing trips at the expense of the companies were made by the representatives of some of the State Insurance Departments. The examinations made were farcical, the examiners being incompetent, not skilled or trained, and the motive was self-aggrandizement, instead of benefit to the policy-holders. However, the exposures of two or three such instances have had a salutary effect, and there is less of it now than heretofore. Nevertheless, the opportunity for the abuse still exists.

Notwithstanding the efforts made since 1871 to get the States to adopt a uniform blank upon which to make returns, there are still a number of States that have not fallen in line, which multiplies labor and increases the expense of the companies. Under the laws of most of the States, the supervisor is given discretion in submitting questions to the companies. When forty-eight supervisors exercise such discretion, it can be readily understood how difficult it is to limit the questions submitted in the blanks to those approved by the National Convention of Insurance Commissioners, which is a voluntary body and has no legal existence. It is nothing unusual, especially for inexperienced supervisors, to introduce some new question, troublesome and expensive to the companies, but of no practical value whatever.

Some of the States have discriminated against insurance companies by imposing a penalty on companies in case they do not succeed in defending a claim believed by the management to be unjust. Such penalty in the State of Texas amounts to 12 per cent. of the claim "together with all reasonable attorneys' fees." In a number of the States, companies are denied the right of trans-

ferring cases to the United States Courts. In others, there are restrictions and conditions which practically amount to a denial of the right to appeal to the highest courts.

In a word, abuse of State regulation of insurance is mainly due to the impossibility of unifying and controlling the Legislatures and supervisors of the forty-eight distinct sovereignties comprising the Union.

*Benefits and Advantage.*—It is safe to say that the legitimate insurance interests of this country would not be willing to give up State regulation and supervision except for something manifestly better. Supervision in the light of legislative regulation has been upon the whole a success. The fault lies with legislative regulation rather than with supervision. The tendency, however, in both legislative regulation and supervision has been in the line of improvement. Largely through the influence of supervision, the business of insurance has been properly classified. While there are yet a few companies acting under old charters, which combine businesses that had better be separated, the general rule of separation of fire, life, casualty, health, etc., obtains.

Safeguards have been adopted for the admission to the several States of only such companies as can show their ability to fulfill their contract obligations. Before a company can be admitted to do business, it must file a certified copy of its charter, an official certificate showing that it is legally authorized to do business in its home State, that it has a surplus over and above all liabilities, and the ability to fulfill its obligations, that it has securities on deposit with the financial officer of its home State worth at least \$100,000, and in case of different lines of business, a larger deposit must be made. It must file its annual statement showing income, disbursements, list of investments, etc.; furnish a certification of valuation of its policy liabilities from the insurance official of its own State, appoint an attorney upon whom legal process may be served, furnish a list of its agents within the State to whom license must be granted by the State before they are authorized to do business, and must allow at the expense of the company an examination of its affairs whenever deemed expedient by the insurance officer of the State. It must also file official copies of all its policy forms and of documents referred to therein or made a part thereof; and there are a number

of other requirements which must be met. These are usually in the line of good business and in the interest of the insuring public.

After a company is regularly admitted, it must comply with the laws of the State, which usually protect the insured against forfeiture, against unreasonable delay in the payment of claims, and require a company to make annually a full exhibit of its affairs, which by most of the States is published in the report of the Insurance Department.

An effective system of supervision economically administered has become an absolute necessity to the business of insurance.

*Taxation Abuse.*—All the abuses of State regulation already mentioned pale into insignificance before the abuse of taxation. Life insurance does not create wealth, it merely distributes and sustains, and is designed to reduce misfortune and pauperism and encourage thrift and stimulate unselfishness and self-dependence. Law-makers, however, because of large accumulations incident to the feature of distribution, feel that these are easy to get at, and, therefore, should be made subject to taxation. The equities and justness have evidently not received due and proper consideration. If they had, it would be found that the tax is paid by the policy-holders themselves, who have already paid taxes in some other form, and it is, therefore, multiplying taxation upon them.

On December 17, 1897, I addressed the American Academy of Political and Social Science, and presented the result of an investigation I had caused to be made in the Philadelphia and Montgomery County almshouses. The census of 1243 paupers with reference to life insurance was taken. Less than 10 per cent. had ever contributed to life insurance, and then only under industrial policies, which generally afford merely a burial fund, and only three were found that had ever been beneficiaries of life insurance. The investigation clearly showed that life insurance is practically unknown to the pauper class, and yet fully 10 per cent. of the paupers had been tradesmen.

The work of the insurance agent is to solicit and encourage men during their productive years to make provision for their families in the event of their death and for themselves in old age, thus waging a constant warfare against pauperism and public dependency. For doing this, which is for the good of the individual and the legislative

organism of society, called the State, the latter imposes a penalty by a multiplication of taxes.

A contrary policy has been pursued in Great Britain ever since it was found through an investigation by a Royal Commission, appointed in 1832, that the life insurance and friendly society movements encouraged thrift, self-reliance, self-dependence, and reduced the poor rate, as shown by section 821 of their report, more than \$10,000,000 annually. According to the terms of Section 54 of 16 and 17 Victoria, cap. 34, every policy-holder in a life and accident company, who may be liable for income tax, is entitled to deduct from his return of income to Government the premium or premiums paid by him under any policy or policies of insurance on the life of himself or his wife, to the extent of not more than one-sixth part of his whole income.

The policy pursued by the States in this country is, that while money deposited in building and loan associations and in savings banks, where it is always available to the depositor, shall be tax free, money deposited with an insurance company, designed to protect dependents in the event of the death of the insured, and not available to the insured, thus preventing pauperism among such dependents, must be taxed not only once but several times, indicated as follows:

1st. Fees to the Insurance Department, including usually a liberal license fee; 2d, license fees of agents; 3d, tax on gross premiums of usually 2 per cent.; 4th, franchise tax or a tax on investments; 5th, augmented frequently by city, county or municipal tax or license fees.

In 1903 it cost the policy-holders in the United States holding policies in level-premium companies \$8,500,000 for taxes, or about six per cent. over and above all direct taxation on the actual property in their possession, of the whole amount paid for death claims and matured endowments. In 1903 the Fidelity Mutual Life Insurance Company paid its officers \$39,664.14 to manage its business, and paid to the States \$69,685.21 in tax and fees for the right to do business.

There is neither uniformity of rate nor method in imposing tax by States. One State will tax reserves, another gross premiums, etc., in addition to the license fees. The latest innovation was made by the State of Nebraska taxing the cash surrender values of

policies, which, however, being a direct tax, will become known to the insured, and probably will be soon repealed.

I admit that the State which gives existence to a corporation has a right to expect a reasonable revenue from it, but submit that it is not good public policy, and is contrary to the spirit of the State "which aims to secure the prevalence of justice by self-imposed laws," to multiply the taxes upon one class of its citizens. It should be remembered that "the great battles for freedom from the earliest times have been fought out on the questions of taxation." State legislation, under the cover of taxation, has been trespassing step by step upon the rights of a class of citizens who have agreed among themselves to make provision for their dependents, until such rights, if such trespassing continues, will be seriously jeopardized.

Insurance corporations should be taxed as all others, on the actual property in their possession, and in addition to this a tax might be imposed to cover the cost of supervision. The cost of supervision, *which should include examination of the companies* (this inspection should be made at the expense of the State and not of the companies), would not exceed 10 per cent. of the amount now collected for taxes and fees.

*State Regulation of Insurance under National Supervision.*—While it would be impracticable and in a manner impossible to dispense with State regulation, I am convinced that it would be to the best interests of the insuring public and the business of insurance to place State regulation under national supervision by Act of Congress.

Before the adoption of the Constitution, it was attempted to control trade under the Articles of Confederation by Legislatures of thirteen distinct sovereignties. Gen. Washington said: "It behooves us to establish just principles, and this cannot, any more than other matters of national concern, be done by thirteen heads differently constructed and organized." Discrimination, confusion and discord among different parts of the Confederacy were in evidence. One of the reforms demanded was introduced and adopted by the Constitutional Convention, and is found in Sec. 8 of Article I, namely: "The Congress shall have the power to regulate commerce with foreign nations, and among the several States, and with the Indian tribes."

The creation of a national bureau of insurance under this sec-

tion would be as simple, logical and conclusive as was the creation of the Department of Commerce. This subject has been discussed for the last thirty years. The opponents of national supervision, and those not informed, refer to the case of *Paul vs. the State of Virginia*, decided by the Supreme Court of the United States in 1869. The question before the court was as to whether Samuel B. Paul violated the Virginia law in representing a company not licensed by the State. Judge Field delivered the opinion of the Court and said: 'Issuing a policy of insurance is not a transaction of commerce. These contracts are not articles of commerce in any proper meaning of the word.'

A careful analysis of the case discloses the fact that the court's statement touching the relation of a policy of insurance to commerce is not entitled to any greater weight than that which ordinarily attaches to what the courts call "*obiter dictum*," and is not, therefore, a precedent for the Supreme Court or for any other court.

As to whether or not insurance is commerce was not germane to and had no bearing whatever upon the case. The decision would have been precisely the same whether Congress has or has not the power to regulate commerce among the States, and whether insurance is or is not commerce. The States have the undoubted right, in the absence of an act of Congress, to regulate the business and prescribe the terms under which foreign corporations may transact business within their borders.

If there had been a Congressional act in force in 1869 declaring insurance to be commerce, then the question would have turned on the constitutionality of such Congressional act, and Judge Field's statement would not have been a mere *dictum* in effect, but a positive expression of the law. "Dicta are judicial opinions expressed by the judges on points that do not necessarily arise in the case. Dicta are regarded as of little authority on account of the manner in which they are delivered, it frequently happening that they are given without much reflection, at the bar, without previous examination." In the case of *Frants vs. Brown*, 17 Serg. and Rawle, 292, Judge Huston said: "I protest against any person considering such *obiter dicta* as my deliberate opinion." Applying this reasoning to the Paul case, and considering the little influence or weight attaching to *obiter dicta* it is evident that that case is no authority on the

question as to whether or not insurance is commerce, and the question is yet an open one, without any judicial conclusion one way or the other.

The next point for consideration is, should Congress declare insurance to be commerce. If so, then it undoubtedly becomes a subject for national supervision, but not until it has been so declared.

The Supreme Court in the case of *Debs* held that "the Government of the United States is one having jurisdiction over every foot of soil within its territory, and acting directly upon each citizen." In considering what was meant by commerce in Section 8 of Article I of the Constitution of the United States, recourse must be had to the generally accepted meaning of the word. Some give it the narrow construction of trading in merchandise. The discord and friction which obtained between the distinct sovereignties under the Articles of Confederation, led such men as Alexander Hamilton, Thomas Paine, Noah Webster, John Jay, James Madison, and Gen. Washington to advocate the framing of a National Constitution which in certain matters should subordinate the States to the Nation.

Alexander Hamilton, in a letter September 3, 1780, to James Duane, contended that "Congress should have complete sovereignty in all that relates to war, peace, trade, finance, foreign affairs, armies, etc." He also, in speaking of the interference and unneighborly relations of States, urged that the "injurious impediments to the *intercourse* between the different parts of the Confederacy" be constrained by National control. Sec. 8 of Article I of the Constitution as adopted accomplishes this.

Commerce practically comprehends trade and finance, and includes insurance. According to the American and English Encyclopædia of Law, vol. 6, p. 217, the term "commerce" includes "all commercial intercourse."

"The word 'commerce,' as used in the Constitution, includes all its ramifications, and every feature or form which it may assume." Ex. p. Crandall, 1 Nev. 312.

"Commerce among the States, within the exclusive regulating power of Congress, consists of intercourse and traffic between their citizens." *In re Green*, 52 Fed. 113.

"By the term commerce is meant not traffic only, but every species of commercial intercourse." *State vs. Delaware*, etc., R. Co., 30 N. J. L. 478.

"Commerce signifies any reciprocal agreement between two persons, by which one delivers to another a thing which the latter accepts, and for which he pays a consideration." *Crow vs. State*, 14 Mo. 247.

"Commerce is undoubtedly traffic, but it is something more; it is intercourse." *Gibbon vs. Ogden*, 9 Wheat. (U. S.) 189

"Commerce is defined to be an exchange of commodities, but this definition does not convey the full meaning of the term. It includes intercourse and navigation." *Henderson vs. New York*, 92 U. S. 259.

"Commerce is a term of the largest import. It comprehends intercourse for the purposes of trade in any and all its forms." *Welton vs. Missouri*, 91 U. S. 280; *Campbell vs. Chicago*, etc., R. Co., 86 Iowa 589.

"The definition given as used in the Constitution of the United States includes intercourse." *Fuller vs. Chicago*, etc., R. Co., 31 Iowa 207.

"Commerce signifies any reciprocal agreements between two persons." *Bouvier's Law Dictionary*, 280.

All authorities seem to agree that commerce comprehends interchange and intercourse in pursuance of agreements between parties. A contract of life insurance is unquestionably a reciprocal agreement between two parties and is a thing of value. In England, the supervision of insurance is in the hands of the Board of Trade; in France, it is looked after by the Minister of Commerce; in Norway, permit must be obtained from the Commercial Registrar; in Austria, it is subject to the Tribunal of Commerce.

*Is Insurance In Reality Commerce?*—Who would have the temerity to assert seriously to-day, and under existing conditions, that insurance is not commerce, that the most colossal and important industry of modern life, involving more money and affecting more people than all the railroads, banks, trust companies and savings institutions combined, extending into every nook and corner of the land, and the subject of sale, barter and pledge wherever business activity exists, is not commerce, especially in contemplation of the Constitution?

Indeed, it is confidently believed that Judge Field himself, if he were alive to-day, in view of the enormous aggregations of capital, the gigantic combinations of all sorts, the revolutionary and progressive methods of business, the augmented necessities incident thereto, the extended powers of the Federal Government under judicial construction, and above all, in view of the prodigiousness of insurance, its universal ramifications, its many uses, trade, commercial and family, and the vast money interests involved, would be one of the first to declare that it is, in the very highest sense, commerce, and conducted as it is to-day, is pre-eminently interstate commerce and subject to Federal supervision and regulation under appropriate Congressional legislation.

Furthermore, the question as to whether insurance is commerce

or not, is not an abstract question of law. It is rather a question of fact and to be determined as other questions of fact are determined. And it is respectfully submitted that intelligent business men are, to say the least, quite as competent to determine the question as judges and lawyers. If, therefore, Congress should declare that insurance is commerce, the question would be thus determined by the greatest and ablest legislative body in the world, whose impartial determination of any question of fact deserves universal acceptance as just and proper. The judges of the Supreme Court would undoubtedly accept Congressional determination of the fact as conclusive, even if they should personally entertain a different view, just as they accept the verdicts of juries. But even in the absence of a declaration to that effect by Congress, if the question should be fairly and squarely presented to the Supreme Court either as a question of law, or fact, or both, the Court would undoubtedly hold that insurance is commerce, in view of the reasons heretofore indicated.

The character of a Federal statute regulating interstate insurance, the privileges and limitations under it, its requirements, the powers and duties of the officials under it, and in fact, the whole scope of such a statute, would require on the part of those who drafted such a law the greatest care and experience.

*Congress Inferentially Declares Insurance to be Commerce.*—Congress, in establishing the Bureau of Corporations of the Department of Commerce and Labor, authorized such Bureau to gather, compile, publish and supply useful information concerning "such corporations doing business within the limits of the United States as shall engage in interstate commerce, or in commerce between the United States and any foreign country, INCLUDING CORPORATIONS ENGAGED IN INSURANCE." This is the first legislative or judicial expression under Federal authority to the effect that corporations engaged in insurance come under the head of "commerce." The natural sequence of the gathering and disseminating of information by the Bureau of Corporations will be the establishment of national supervision of insurance.

State regulation would, with the exception of the powers and authority delegated by national supervision, be limited to the regulation within its own borders of the corporations to which the State

gives existence. State legislative regulation would virtually be at an end, as it should be; but State supervision could no doubt be subordinated to and be the representative of national supervision. If a State maintains a bureau, then there is no reason why records, so far as they relate to companies doing business in such State, should not be furnished by the National to the State bureau for the information of the citizens of such State. The relationship of State regulation to national supervision will give rise to many important questions which require careful consideration.

Until Congress exercises the power conferred upon it by the Constitution to provide national supervision, the States will continue to exercise such right, because it is not forbidden, and because supervision is a necessity.